Great Southern Bank (Q3 2018 Earnings)

October 18, 2018

Corporate Speakers:

- Kelly A. Polonus, Great Southern Bancorp, Inc., Director of Communications, Marketing
- Joseph William Turner, Great Southern Bancorp, Inc., President, CEO, Director
- Rex A. Copeland, Great Southern Bank, SVP, CFO

Participants:

- Andrew Brian Liesch, Sandler O'Neill + Partners, L.P., Analyst
- Michael Anthony Perito, Keefe, Bruyette, & Woods, Inc., Analyst
- John Lawrence Rodis, FIG Partners, LLC, Analyst

PRESENTATION

Operator: Welcome to the Great Southern Bancorp Third Quarter 2018 Earnings Conference Call.

(Operator Instructions)

I would now like to introduce your host for today's conference, Kelly Polonus, Investor Relations.

Kelly A. Polonus: This is Kelly Polonus, Investor Relations for Great Southern Bancorp.

The purpose of our call today is to discuss the Company's results for the quarter ending September 30, 2018.

Before we begin, I need to remind you that during the course of this call, we may make forward-looking statements about future events and future financial performance. You should not place undue reliance on any forward-looking statements, which speak only as of the date they are made. These statements are subject to a number of factors that could cause actual results to differ materially from the result anticipated or projected.

For a list of some of these factors, please see the forward-looking statements disclosure in our third quarter 2018 earnings release.

President and CEO, Joe Turner, and Chief Financial Officer, Rex Copeland, are here with me.

And I'll turn the call over to Joe.

Joseph William Turner: I want to thank you for joining our third quarter earnings call. As always, I'll provide some remarks, general remarks about our performance during the

quarter, and then Rex will talk a little bit more specifically about the income statement detail.

Hopefully, you've had a chance to at least glance at our earnings release. If you have, you've seen that we had a very strong quarter; we earned $22.5 million during the quarter or $1.57 a share. Our returns were 17.8% on common equity and 1.99% on assets with a margin of 4.02%.

Obviously, during the quarter, one of the big things that happened we did close our sales about $54 million to $56 million of deposits in the Omaha area plus the related banking facilities that generated a gain of $7.25 million pretax. After tax that was $0.39 a share so our core earnings during the quarter were $1.18, and our quarter returns were 1.49% on assets and 13.35% on equity.

We continue to feel really good about our loan portfolio, both in terms of growth and performance. Our loan portfolio grew $83 million during the quarter. From the end of 2017, it's grown $217 million. And that, of course, is net of $79 million, Rex, in decreases in the consumer portfolio as a result of our a little tougher underwriting guidelines. We've also had about a $32 million decrease in our FDIC portfolio.

Our pipeline continues to be strong. We're up about $163 million from the end of 2017. Our newest loan production offices in Atlanta and Denver will come online officially in the fourth quarter. We, of course, have personnel working in both offices right now.

Asset quality, we felt like was awfully strong at the end of the second quarter, and I think got slightly better during this quarter. Nonperforming assets and potential problem loans, what we would think of as our total bucket of problems, decreased $11 million from the end of the second quarter. Large portion of the decrease was a result of the decrease in our foreclosed real estate of $4 million. Nonperforming loans decreased $2 million from the end of the second quarter and potential problem loans decreased $5.4 million from the end of the second quarter.

Our capital position continues to be strong. Obviously, you see our capital ratios in light of the strong capital position, also, in light of the positive projection of our earnings levels and asset quality levels. Our board elected to increase the quarterly dividend in the third quarter to $0.32 a share. Capital has grown about $36 million during the first 9 months of 2018. We're now at 11.1% of assets, $35.90 a share book value and about a 10.9% tangible common equity to asset ratio.

That concludes my remarks. And I'll turn the call over to Rex at this time.

Rex A. Copeland: I'm going to start with net interest margin.

Our reported margin in the third quarter was 4.02%. The core margin, which excludes the impacts of our additional yield accretion on our FDIC-acquired loan portfolios expanded

to 3.88% during the quarter, which was about 20 basis points higher than it was in the year-ago quarter and about 4 basis points more than it was in the second quarter this year.

Driving that throughout the year has really been increased yields on most of our loans, increased growth in our loan categories as well. Also, our yields on investments and funds that we have at the Federal Reserve Bank are yielding higher rates. And partially offset by an increase in our deposit costs and also some increased costs on home loan bank borrowings.

As we've indicated in the past filings that rising interest rates would have a modest positive effect on net interest income and margin, we're seeing that so far this year. Competition though remains significant, and we're seeing increased costs, more deposits and other borrowings. And we continue to anticipate that, that likely will put a little bit of pressure on margin expansion as we move forward.

As Joe mentioned earlier, some of the headwinds to our margin improvement have been the lower level of consumer loans and just, in general, lower amounts of accretion income. I think in the third quarter, our accretion income was actually up a little bit. But as a general kind of a trend, that has been lower than it's been in previous periods.

And we did see, I think, probably similar to what most banks are experiencing, we did see our cost of deposits increase more in the third quarter as opposed to what we saw in the second quarter and previous quarters to that. And our cost of borrowings in general will be affected by the changes in LIBOR rates as they move ahead.

Next, I'll just talk briefly about noninterest income. Obviously, we were higher this year by about $7 million compared to the third quarter last year. Joe mentioned already, the sale of the Omaha branches was the main driver of that. We also had a little bit lower amount, $300,000 or so less, in gains on sale of one- to four-family residential loans. We've originated less fixed-rate loans this year compared to last year and originated more hybrid arms. They're going to have terms of fixed rate periods for 3, 5, maybe 7 years before they become annually adjustable.

Our provision for loan losses was down a little bit this quarter compared to the previous year quarter. We did have a loan that we recovered on this period. It wasn't really recovery, we had it fully reserved. We were able to release the reserve that we had on that loan; that was about $900,000.

Expenses. Our noninterest expense, I think we've done a fairly good job of containing that. Our efficiency's remaining good and the focus for our Company. Total noninterest expenses were $28.3 million this quarter compared to about $28 million in the third quarter last year and about close to $30 million or so in the second quarter of this year.

We did see increased expenses in a couple of categories, occupancy and equipment expense. We did have some upgrades that we did to ATMs to make them more fully

functional as interactive teller machines, things of that nature, also some repairs and maintenance type deals that we had in some of our branch network.

And then also some legal and professional fee increases that we had in this period. Also, costs were about $165,000 related to the Omaha transaction that flowed through noninterest expense.

Again, our core operating expenses, I think, are staying relatively stable and we continue to be focused on that.

That concludes our prepared remarks. And at this time, we'll turn it over for questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions)

Andrew Liesch with Sandler O'Neill.

Andrew Brian Liesch: Question's on just loan production going forward. These last couple of quarters have been two of your best in years. Just kind of curious on your outlook, I mean, the pipeline is strong and certainly having competitive payoffs, but is this like high single-digit rate sustainable just with what you see in the pipeline?

Joseph William Turner: You've heard us address this kind of question before, Andrew. We don't give forward guidance on loan growth or those sorts of things. I think it's too difficult to do. There's too much of it that's out of our control, very competitive landscape, so we don't know what competitors are going to be doing. Just too hard to gauge.

I will say we feel good about our levels of activity in all the areas where we produce loans. And that's across all geographies, across all product lines and as you say, we feel like our pipeline is strong.

Andrew Brian Liesch: And then just turning more towards the margin. Sounds like the deposit costs with how they rose last quarter, that may continue following this latest rate hike. If I roll everything together based on what you said, there may be a little, maybe compression but certainly not like wild expansion, if anything there's expansion similar to, or at best, what we saw this last quarter on a core basis?

Rex A. Copeland: Probably so. I think what we're seeing is probably what the industry has been describing. And that is we got the benefit for a long time, the first 100 basis points of interest rate increases. We probably saw a lot of benefit on the loan side; not as much determent on the deposit side.

And I'd say we're seeing the level of competition to maintain and grow deposits. We're seeing a lot more necessity to selectively raise some deposit rates here and there. With the

franchise that we have, we do certain things in some markets and maybe not in others, but we do continue to think that. If you look back at just the change in our deposit cost by the last 4, 5 quarters, you can see that deposit costs maybe a year ago were only going up 4 or 5 basis points a quarter and this past quarter, they went up 15 basis points.

Operator: Michael Perito with KBW.

Michael Anthony Perito: I wanted to start maybe asking Andrew's loan growth question a bit differently. After the successful branch sale, which gave you a nice boost to returns and capital this quarter, and obviously you had some deposits flow out the door as well though, so in the context of kind of the balance sheet capacity to lend, how should we think about the go-forward strategy to funding incremental loan growth with the kind of loan-to-deposit ratio where it is?

And just any updated thoughts on that post-branch sale would be appreciated.

Joseph William Turner: Yes. I think, Mike, we got this question or a similar question last quarter. And I think our answer would be very similar this quarter. I think that deposit growth tends to be cyclical, and we're in a part of the cycle where deposits are not growing nearly as quickly as loans.

We feel like we have alternative capacity with broker deposits, with Federal Home Loan Bank borrowings, with CDARS deposits, those sort of thing. We feel like we have capacity to fund relatively robust loan growth for several quarters. We're not certainly immediately concerned. But obviously, over the long term, in order to grow our balance sheet, yes, we are going to have to grow deposits.

And we think the fortunate thing about us is we have the infrastructure in place to do that. We have 99 branches. A little over $40 million or around $40 million deposit per branch. We can, obviously, handle a lot more than that. As I said last quarter, our franchise being in a number of metropolitan areas, we're able to selectively raise rates with specials and so forth in a specific Metro market and not reprice everything in the portfolio.

We're also relatively far down the road, hopefully it will roll out by the end of the year to having a better, more robust online product where we can sort of look for areas of the country that are maybe not as competitive on the deposit side and grow deposits that way.

Michael Anthony Perito: Add on that last point, I mean, is that type of product meant to compete with a lot of the other kind of online money market type of accounts that we see out there today? I think where you see a lot of the incremental funding being raised north of 2% or is that something different that you guys are trying to create?

Joseph William Turner: I don't know that we've zeroed in on a rate yet. I mean, we're not really, really aggressive ratepayers. I don't know that we'll compete on just strictly on price basis on everything. But we'll look for places maybe that are a little weaker and try to capitalize on that.

Rex A. Copeland: But it will be a money market.

Joseph William Turner: Yes, a money market type product, yes.

Michael Anthony Perito: And then just kind of curious, I mean, I'm sure you're kind of getting into that, if not already there, that 2019 budgeting season and post-branch sale also, capital levels are fairly robust. The bank group obviously has come under a little pressure in the public markets for last few weeks. Just curious how you're thinking about that buyback?

And generally, any other thoughts about capital deployment? You obviously had the dividend in the quarter, which was a nice raise, but just curious about any other thoughts you can give us on capital deployment as you look out to next year at this point?

Joseph William Turner: Yes, I mean, I think, we would all agree that an 11% roughly tangible common equity to asset ratios is pretty strong. I think there's room for buybacks. Obviously, our stock is more attractive at this point than it was a month or 2 ago. And so whereas an earn-back analysis at $60 might not have been that attractive, it is a little more attractive where the stock's trading right now.

There's also a possibility of kind of special dividends too and that will be something our board will consider. And I don't think a buyback and a special dividend would necessarily be mutually exclusive. I think we have a number of alternatives we can review.

Rex A. Copeland: And another piece of it would just be if we feel like our loan growth is going to continue on or we see more loan growth, then obviously we'll need capital to support that.

Joseph William Turner: Yes.

Michael Anthony Perito: Is there a level of capital where it becomes a point where you have to do something in your mind?

Joseph William Turner: I don't think so. I don't think so, Mike.

Operator: John Rodis with FIG Partners.

John Lawrence Rodis: Rex, your comment on the provision, did you say there was a reversal of like $900,000 this quarter? Could you repeat that?

Rex A. Copeland: No, we had a position that we had fully reserved in our allowance for loan loss. And we actually collected on that loan. Our net charge-offs were only about $1.4 million. We had a little lower. We didn't need to put any additional provision in. And so our provision expense was only about $1.3 million this quarter.

John Lawrence Rodis: But all things equal, without that, the provision would have been higher, I guess, by that like amount? Is that what you're sort of saying?

Rex A. Copeland: No. Well, I mean, what we needed to have was roughly what we had as far as the net charge-off. And so that $900,000 didn't come back through and reduce our net charge-off; that was just something that we already fully allocated for. If our net charge-offs would have been higher, we may have had to need to put an additional provision in. But they were fairly low this quarter.

John Lawrence Rodis: And then you actually grew the securities portfolio this quarter a little bit. I don't know, is this just putting some of the gains to work from the branch sale or can you maybe just address that?

Rex A. Copeland: There is a couple of things that we're doing with that. One is obviously, it's a pledgeable asset. Number two, we're looking at some ways that we can mitigate risk to us in potentially a falling rate environment down the road. And so we're putting on some securities that will be of some benefit to us there. And at least one of the securities involved in this does benefit us from a CRA perspective.

I think we would be looking at probably adding a few more securities into the portfolio of this nature, not like lots of it at one time, but a little bit as we move forward quarter by quarter, primarily to help us with down the road should interest rate start to decrease, they'll help mitigate some of the risk to us to falling rates.

John Lawrence Rodis: I assume just the growth in that portfolio, it's probably dilutive to the margin but positive to net interest income? Is that correct?

Rex A. Copeland: Right.

Joseph William Turner: Yes. I think that was correct.

Rex A. Copeland: The yields are not going to be as high as loan yields. But they're going to be in the maybe mid-3% kind of stuff.

John Lawrence Rodis: And then, Rex, just as far as you gave your sort of outlook for tax rates, and I think it's primarily for this year, but as of right now sort of similar tax rates going forward for 2019?

Rex A. Copeland: Yes. This year and in this particular quarter with the large gain that we had, that obviously ate up more of our tax-advantaged items than normal. And so that caused our effective tax rate to be a little bit higher than we've been running the last few quarters.

Operator: And that concludes our Q&A session for today. I will turn the call back over.

Kelly A. Polonus: I appreciate everybody calling in today on our third quarter earnings. And if anyone has any further questions, please feel free to contact me; I'd be glad to help. And if not, we'll adjourn. Thank you, again.

Joseph William Turner: Thank you.

Operator: Ladies and gentlemen, thank you for your participating in today's conference. This does conclude today's program. You may all disconnect.